SIDLEY AUSTIN BROWN & WOOD
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

CHICAGO
DALLAS
LOS ANGELES
NEW YORK
SAN FRANCISCO
SEATTLE

1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com
FOUNDED 1866

BEIJING
HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
(202) 736-8000

ORIGINAL



June 1, 2001

**Ex Parte Presentation**

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: *Application of Southwestern Bell for Provision of In-Region, InterLATA Services in Missouri, CC Docket No. 01-88*

Dear Ms. Salas:

This *ex parte letter*, which is filed at the Commission Staff's request, addresses certain pricing arguments raised by Southwestern Bell ("SWBT") for the first time in its May 16, 2001 reply comments. As detailed below, SWBT's responses to the many serious violations of Commission pricing rules and basic forward-looking costing principles identified by commenters amount to little more than platitudes and unsupported assurances that answers can be found in cost models that SWBT refuses even to make available for review. What little evidentiary support SWBT does provide in support of its extravagant claims of TELRIC compliance – in particular, the reply declarations of Barbara Smith and Tim Morrissey – only confirms that SWBT's Missouri rates are not remotely cost-based.

As SWBT concedes, its Missouri rates are, in many cases, the highest in its five state region, notwithstanding that costs are, in many cases, *lower* in Missouri. *See* SWBT Reply at 3. SWBT disagrees with some specifics of AT&T's relative rate/cost comparisons, but SWBT's alternative approach yields the same conclusion: the enormous disparities between SWBT's Missouri rates and its rates in other SWBT states cannot be explained by cost differences. For example, SWBT's zone-specific analysis, like AT&T's study-area analysis, shows that SWBT's Missouri loop rates exceed those in Kansas and Texas by a large margin and that those rate differences are not a product of cost differences.[1] Loop rate/cost comparisons to

[1] SWBT's analysis shows unexplained rate differences between Missouri and Kansas in rural, suburban and urban zones of 25%, 36% and 14%, respectively. *See* Morrissey Reply Decl. ¶ 7 (computed using the rate/cost discrepancies identified in this paragraph). For Texas, SWBT's analysis generates unexplained rate differences of 7%, 13% and -5% for rural, suburban and urban zones respectively. *See id.*

ORIGINAL

Oklahoma and Arkansas tell the same story. *See* Lieberman Decl., Table 2 (showing unexplained rate differences between Missouri and Oklahoma (15%) and Arkansas (35%)). SWBT provides no alternative Oklahoma or Kansas loop comparisons, and it provides no rate/cost analyses at all with respect to switch usage or other elements.[2] SWBT also does not deny that its non-recurring charges ("NRCs") in Missouri greatly exceed its NRCs in other states. And SWBT declines to provide any rate/cost comparison of the UNE-Platform between Missouri and any other SWBT state. *Cf.* Lieberman Reply Decl., Tables 1 & 2 (showing that Missouri's UNE-platform rates for Missouri greatly exceed those in Arkansas even though Missouri costs are lower than those in Arkansas).[3]

Recognizing that its Missouri rates cannot survive a relative rate/cost comparison with any state in which SWBT has previously sought and obtained section 271 authority, SWBT urges the Commission either to ignore such comparisons altogether or to endorse a "mix and match" approach in which large rate/cost disparities relative to another state can be ignored if SWBT can, for each disputed rate element, point to another state – if necessary, a different state for *each* element – where the rate/cost disparity is less stark. The Commission has rejected the former, *see Mass. 271 Order*, CC Docket No. 01-9, ¶ 22 (April 16, 2001) ("the USF cost model provides a reasonable basis for comparing cost differences between states"). The Commission plainly should reject the latter. Any such shell game approach to UNE rate/cost comparisons that established as "benchmarks" only the *highest* approved rate for each individual element would be entirely arbitrary, would result in an ever expanding range of "reasonableness," and could not possibly survive judicial review.[4] Moreover, any such approach would create perverse incentives

---

[2] SWBT points out that its Missouri rates are lower than the Synthesis Model estimates of Missouri costs. *See* Morrissey Reply Decl ¶ 9. But the Commission held in SWBT's last section 271 proceeding that it will not consider *direct* comparisons of a state's rates to the Synthesis Model cost estimate for that state, but only *relative* rate/cost comparisons. *See, e.g., Kansas/Oklahoma 271 Order*, CC Docket No. 00-217, ¶ 84 (January 22, 2001) ("the USF cost model should not be relied upon to set rates for UNEs, [however] it accurately reflects the relative cost differences among states"). And SWBT's arguments why relative Synthesis Model comparisons should nonetheless be disregarded are baseless. Although the Synthesis Model does include "retail" costs, *see* Morrissey ¶ 5, it assumes the *same* retail costs in each state, thus removing retail rates simply reduces cost estimates by the same amount in each state. SWBT's claim that the Synthesis model "does not capture study area-specific costs," *id*, is simply false. The Commission's model employs vast amounts of area-specific input data, including customer location and terrain data. *See Inputs Order* ¶¶ 36-62. Moreover, NECA data – which certainly reflects all study area-specific costs – reveals even *greater* unexplained Missouri loop rate/cost disparities than the Synthesis Model comparisons that SWBT challenges. *See* Lieberman Decl. ¶ 23.

[3] SWBT urges the Commission to look instead to New York (and Massachusetts, where Verizon claims it offers New York-equivalent rates) as the Missouri analog. *See, e.g.*, Morrissey ¶ 10. But even if that were appropriate the New York PSC's ALJ recently recommended that Verizon be ordered to decrease its excessive New York rates to levels that will make the New York UNE platform cost 21% *less* than the Missouri UNE platform. *See Proceeding on the Motion of the Commission to Examine New York Telephone Company's Rates For Unbundled Network Elements*, Recommended Decision on Module 3 Issues, Case 98-C-1357 (May 16, 2001) ("*New York Re-Examination Decision*"). The Massachusetts Commission is likewise considering requests that Verizon be ordered to reduce its rates in that state.

[4] *See, e.g., Public Service Company of Indiana v. ICC*, 249 F.2d 753 (1984) (rejecting as arbitrary an ICC finding that a railroad was inefficient based only upon a comparison of that railroad to the nation's most profitable railroad,

that would greatly increase the scope and frequency of rate litigation in section 271 proceedings. Even in a state where UNE rate levels, were, on the whole, reasonably close to TELRIC levels, for example, competing carriers would be encouraged – indeed, required – to litigate the individual rate elements that strayed furthest from TELRIC for fear that those rate elements would later be used to justify rates for those elements in another state in which UNE rates were, on the whole, excessive (and that other excessive rate elements in the latter state would then be justified by "outlier" rate elements from still other states). For their part, the BOCs would be encouraged to game the system by selectively reducing particular rate elements (and leaving others at inflated levels) in their early section 271 applications, so that later applications could benefit from a mix and match of inflated rates for *all* key elements.

The potential for BOCs to game the system in this way is especially great now that the Commission has approved section 271 applications in a number of states. The pool of UNE rates currently available to BOCs to justify any newly proposed UNE rates is already quite large. And as the number of section 271 approved states increases, the ability of BOC's to justify higher and higher UNE rates would increase as well. Further, the Commission should not allow BOCs to justify newly proposed rates by comparing them to rates in states that were themselves justified by such a comparison. For example, the Commission approved SWBT's Oklahoma UNE loop rates because they fell within some "reasonable range" above those in Texas. To now assess Missouri's rates based on Oklahoma's rates would increase the benchmark around which the Commission established its "range of reasonableness," even though no new information is available to support such an increase.[5] The result of that analysis would be an impermissible widening of that "range of reasonableness."[6] Thus, if the Commission is to rely upon relative comparisons, it should look at only a single benchmark state where the methodology used to develop recurring UNE rates was clearly TELRIC-compatible. The only appropriate state for analyzing Missouri's UNE rates is Kansas. *See* AT&T Reply at 11; DOJ Eval. 12 & nn. 42, 43. The Kansas Commission's application of TELRIC methodology is the

---

a selective comparison that the Court noted "suggests manipulation"); *Illinois Telecommunications Ass'n v. FCC*, 123 F.3d 693, 694 (1997) (rejecting as arbitrary the FCC's decision to assume that originating 800 calls would be same as originating other types of payphone calls, especially since the record shows that other comparisons may be more appropriate); *Tennessee Gas Pipeline v. FERC*, 926 F.2d 1206, 1209 (1991) (rejecting as arbitrary the agency's decision to justify a single rate from some "zone of reasonableness," noting that such analysis is "a standardless exercise of Commission discretion resting on no more than an assertion of expertise").

[5] In this regard, SWBT's proposal to mix-and-match UNE rates comparisons for individual UNEs across states violates basic statistics principles. In particular, that analysis introduces systematic bias into the analysis by impermissibly increasing the benchmark around which the "reasonable range" is determined based solely on the fact that the higher benchmark was found to be within a reasonable range of the original benchmark. *See* Robert S. Pindyck & Daniel L. Rubinfeld, *Economic Models & Economic Forecasts*, McGraw Hill, Inc. (3d ed. 1991) (pointing out that such systematic bias that could result in incorrect conclusions regarding any ranges about that biased average); *see also* Thomas H. Wonnnacott & Ronald J. Wannacott, *Introductory Statistics for Business and Economics*, John Wiley & Sons (4th ed. 1990) (illustrating the problems associated with biased estimators).

[6] In its *Kansas/Oklahoma Order* (¶ 79 n.238), for example, the Commission found that Oklahoma's transport rates which exceeded those in Texas by 37% were within a "reasonable range."

only one that has been accepted by all affected parties as implementing TELRIC for recurring rates; even SWBT has effectively endorsed the Kansas recurring UNE rates by recommending that the Arkansas Commission borrow them for adoption in Arkansas.[7]

In short, SWBT's Missouri UNE rates exceed its rates in each of its other states by wide margins and this rate inflation does not reflect legitimate cost differences.[8] In these circumstances, both the Act and the Commission's prior section 271 decisions demand that the Commission conduct its own independent review and that SWBT can meet its Checklist Item 2 burden only with detailed and verifiable cost evidence that demonstrates that its Missouri rates comply with the Commission's TELRIC rules. SWBT plainly has not met that burden.

AT&T, Worldcom, DOJ and others have documented numerous serious TELRIC violations that explain why SWBT's Missouri rates exceed its rates in other states. In its reply comments, SWBT confirms many of these violations, but contends that they are "minor" or that the resulting cost inflation is offset by cost study mistakes that SWBT claims it made in the other direction. SWBT denies the existence of other TELRIC violations, claiming that AT&T, the DOJ, the Missouri PSC Staff and others have all "misunderstood" SWBT's cost studies. *See, e.g.*, SWBT Reply at 14. These arguments must be rejected out of hand, because SWBT's bald assertions about its cost studies are entirely unsupported. There is no dispute that SWBT has refused to place its full Missouri cost studies in the record. Yet, throughout its reply comments, SWBT claims that details of those models would clear up "misunderstandings" about the operation of the models and confirm that they toe the TELRIC line. SWBT recognizes, of course, that the Commission and commenters have little ability to refute (or verify) these claims without access to the cost studies, and thus SWBT is free to say almost anything about them. SWBT now asks the Commission to play the fool and endorse this "trust me" approach to checklist compliance. The Commission has already properly rejected that approach as a general matter, *see, e.g., Kansas/Oklahoma 271 Order* ¶ 10 (a finding of checklist compliance is possible only when "the factual record supports the conclusion"), and SWBT's recent track record makes clear that it would be a particularly poor candidate for an honor system approach.[9]

---

[7] Kansas non-recurring rates, however, are not remotely cost based. *See Sprint Communications Co. et al. v. FCC, No. 01-1076 et al.*, Brief of Appellants, at 30-36 (D.C. Cir. filed April 30, 2001).

[8] SWBT also claims that AT&T's margin analysis is flawed because it understates the amount of revenue available to CLECs for Metropolitan Calling Area ("MCA") rates. *See* Sparks Reply Decl. ¶ 30. But adjusting the MCA so that it is averaged only over those lines where it is available would not change the fact that margins in Missouri's rural and suburban areas are negative. Moreover, redistributing MCA revenues would not affect the overall average margin and consequently would not change the fact that statewide UNE-platform margins are negative. In contrast, SWBT's comparison of its Missouri UNE-platform rates to those in New York and Massachusetts is flawed because those comparisons are based on old rates. *See* n.3, *supra*.

[9] *See, e.g.*, Ex Parte Letter from Geoffrey Klineberg, Kellogg, Huber, Hansen, Todd & Evans, to Magalie Roman Salas, Federal Communications Commission (April 13, 2001); Ex Parte Letter from John D. Lee, Comptel, to Magalie Roman Salas, Federal Communications Commission (May 21, 2001) ("this is not the first time SBC has had difficulty with candor to the FCC"); Order On Review, *SBC Communications Inc., Apparent Liability For Forfeiture*, File No. EB-00-IH-0432, NAL/Acct. No. 200132080011 (May 29, 2001) (fining SBC $88,000 because

Because the section 271 process so obviously depends upon full, timely and extended electronic access to the cost studies that a BOC claims demonstrate its compliance with the cost-based rate requirement, SWBT contends in the alternative that it has provided commenters with "sufficient" access.[10] AT&T and others have previously documented the patent inadequacy of the few Missouri spreadsheets that SWBT belatedly filed in this proceeding. *See* AT&T Reply at 23-25; MCI Reply at 4-5. SWBT notes that AT&T and others were provided with greater access to SWBT's Missouri studies in 1996-97 during the Missouri rate proceedings, Kern Reply Decl. ¶¶ 4-7, but fails to note that the permitted review was only of *hard copies* of the cost studies – on SWBT's premises where only limited notes could be taken – and, in the case of key replacement studies, was limited to *the evening before* the hearings at which AT&T cost witnesses were called to testify. Alternatively, SWBT claims, commenters can refer back to their 1996-97 electronic review of SWBT's *Texas* cost studies, which SWBT claims are the same as the Missouri cost studies. *See* Smith Decl. ¶¶ 8-10. Without access to the Missouri studies, there is, of course, no way to verify this claim. Moreover, as SWBT repeatedly emphasizes elsewhere in its reply comments, cost models require the use of state-specific inputs, samples and studies. SWBT's LPVST model (used to compute UNE loop rates), for example, relies on SWBT's Missouri Loop Sample Survey, SWBT's Missouri Broadgauge Cost Study, SWBT's CAPCOST Model, SWBT's Missouri Maintenance and Other Cost Factors, none of which have been submitted in this proceeding in electronic form (and most of which have not been provided in *any* form). In any event, commenters would be precluded by SWBT's strict protective order in the Texas or other state proceedings from using SWBT data, models, or access to SWBT mainframe programs gained in other states in any way to restate or revise SWBT's Missouri UNE studies.[11] In short, SWBT has utterly failed to meet its Checklist Item 2 burden, and it cannot be permitted to shift that burden to commenters.

---

SBC "use[d] misleading statistics and . . . comparisons . . . [and has] significantly overstated the accuracy of its findings"); Kenneth Hoexter, *SBC Ignores Rules, Pays 4th Fine,* Merrill Lynch Global Securities Research, Apr. 13, 2001 (noting that SBC has paid $23 million in fines for violations of Commission Orders and "prefer[s] to pay fines as a part of business, compared [to] . . . open[ing] the markets to local competition"); *Ex Parte Letter* from Richard Young to Magalie Roman Salas, Secretary, at 5-8 (May 24, 2001) (demonstrating that SWBT misrepresented the procedures it has undertaken to fix its LMOS systems).

[10] SBC's cost studies are a complex grouping of independent but interrelated studies and processes that necessarily have to be modified independently and in sequence in order to determine changes in ultimate output. For example, the local switching study requires the use of the SCIS model, the CAPCOST model, the "Cost Factors Binder" (which includes a distinct modeling of numerous cost factors such as maintenance factors and support asset factors) and the ACES model. In addition, outputs from one model must be manually transferred to the next model, sometimes after additional manipulation of the outputs on independent spreadsheets.

[11] The only Texas studies in this record are paper copies that SWBT submitted only days ago. Those studies include two separate SWBT computations of local switch usage costs – one from January 1997 and a second from November 1997. The studies do *not*, however, include any computations of SWBT's UNE loop cost, nor do they show how SWBT's annual cost factors were developed. For these reasons, the data submitted by SWBT are insufficient reproduce even SWBT's Texas cost studies. However, review of the two Texas studies does reveal that the inputs used in Texas produced switch local usage costs that are between 8 and 17 percentage points lower than those used by SWBT for Missouri, which again confirms that SWBT's Missouri switch usage rates are inflated.

But even on the limited evidentiary record SWBT has chosen to establish, it is clear that the TELRIC violations commenters have identified do exist and have substantially inflated SWBT's Missouri rates.

**A. Generic TELRIC Violations That Inflate All UNE Rates.**

*Unlawful Reproduction Cost Assumptions.* SWBT's reply comments confirm beyond doubt that SWBT's Missouri UNE rates reflect impermissible reproduction cost assumptions that violate the efficient replacement cost approach demanded by the Commission's rules. *See* 47 C.F.R. § 51.505(b)(1). SWBT now concedes, for example, that its loop rates do not reflect the cable sizes and runs that an efficient, cost-minimizing competitor would deploy, but instead simply reprice SWBT's embedded 1996 cable inventory: "All of the cable sizes and their corresponding lengths from the company inventory of cables are used in the calculation of the average pair foot investment for the total cable including feeder and distribution." Smith Reply Aff. at ¶ 43. *See also id.* at ¶ 41 ("SBC keeps records of the types and amounts of cable placed in its network. This inventory, used with the current 'Broadgauge' costs for cable, was used to develop the average cost per pair foot for feeder and distribution"); AT&T Comments at 13-16; AT&T Reply Comments 11. As the Commission has recently explained to the Supreme Court, that is flatly inconsistent with the TELRIC rules. *See* Brief of the FCC, *Verizon Commun., Inc. v. FCC*, at 6-7, *cert. granted*, 121 S.Ct. 877-89 (2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602) (an "assets 'forward-looking' cost (also known as its 'replacement' or 'economic cost')," must be distinguished from "the cost of duplicating the asset in every physical particular (sometimes called an item's 'reproduction' or 'replication' cost")).

SWBT responds that its cost models are not based *entirely* on reproduction cost and that they include many replacement cost assumptions. *See, e.g.*, Smith Reply Aff. at ¶¶ 35-39. AT&T has never claimed otherwise *See* AT&T Comments at 14. But compliance with the TELRIC rules in *some* respects obviously cannot cure other admitted violations of those rules. TELRIC requires an approach that replaces a BOC's existing technologies, equipment and architectures *whenever* more efficient replacements are available; not a "hybrid" approach that makes some correct replacement assumptions but, in other important respects, blindly assumes reproduction of the existing architectures, equipment and technologies.[12]

*Depreciation.* SWBT's depreciation argument boils down to this: (1) economic depreciation should properly reflect expected obsolescence, and not just physical deterioration, (2) the Commission-approved depreciation lives, which the Missouri PSC rejected, do not, and

[12] SWBT's statement that the alternative cost model submitted by AT&T in the Missouri proceedings was based upon a "scorched earth" approach (Smith Reply Aff. ¶ 18) – *i.e.* that it fails to take the location of existing wire centers as given – is false (as well as irrelevant). *See* Model Description, Hatfield Model Version 2.2., Release 2, September 4, 1996, *AT&T Communications Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company*, Case No. TO-97-40, at 26 (filed September 16, 1996) (explaining that the Hatfield Model uses "existing tandem and end office wire center locations" for computing UNE costs); *see also* Direct Testimony of Robert P. Flappan, Case No. TO-97-40, at 9 (filed September 16, 1996) ("the Hatfield Model takes the incumbent LEC's existing wire center locations as a given").

(3) the SWBT proposals, upon which the Missouri depreciation lives were based, do. The latter two statements are plainly false. As the Commission recently explained, its depreciation lives – which most states have used in establishing UNE rates – fully and properly account for obsolescence and are therefore appropriate for use in estimating the forward-looking costs of UNEs.[13] *See* Tenth Report and Order, *Federal-State Joint Board on Universal Service,* CC Docket Nos. 96-45, 97-160, ¶ 426 (1999) ("*Inputs Order*") ("Commission-authorized depreciation lives are not only estimates of the physical lives of assets, but also reflect the impact of technological obsolescence and forecasts of equipment replacement"); Memorandum Opinion and Order in ASD 98-91, *1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, Unites States Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers,* ¶ 17 (released December 30, 1999) ("*Depreciation Order*") ¶ 33 ("twenty-four states' commissions have required incumbent LECs to use FCC-prescribed projection lives. . . . We are concerned that forbearance form depreciation regulation by the Commission might deprive state regulatory commissions of [the ability to rely on those factors]"); *see also Kansas/Oklahoma 271 Order*¶ 76 ("it would be reasonable for a state to follow the depreciation rates the Commission has set for regulation of SWBT's interstate services").

The record with respect to SWBT's depreciation proposals is somewhat murkier. Based on SWBT's December 1996 testimony that its Missouri proposals were "consistent with" its financial accounting lives, AT&T had believed that SWBT's proposals were lifted from its accounting statements.[14] As GTE has explained, financial accounting lives are governed by the Generally Accepted Accounting Principle ("GAAP") of "conservatism" which "prefers the *understatement* . . . of net income and net assets where any potential problems exist."[15] Thus, it is not surprising either that financial depreciation lives often differ from those approved by the Commission for regulatory purposes by as much as 100 percent, *see* Baranowski Decl., Table 1, or that the Commission has elsewhere expressly rejected the use of financial accounting lives for regulatory purposes. *See Depreciation Order* ¶ 17 (rejecting the use of financial accounting lives and pointing that other regulatory bodies "have statutory duties that differ from the requirements imposed on [the Commission] by the Act"). Although SWBT is quick in its reply comments to embrace the Commission's recent statement that the use of financial accounting lives is not

---

[13] Also SWBT's use of short depreciation lives is particularly inconsistent with its use of embedded fill factors and maintenance costs. For example, if SWBT's loop assets depreciate faster on a forward-looking basis than they have in the past, then SWBT embedded fill factors are too low to account for the fact that its loops will need to be replaced sooner than in the past. Likewise, if SWBT's assets depreciate faster on a forward-looking basis, SWBT's embedded maintenance factors will be too high because they will assume that maintenance is required for a longer time period than those assets are assumed to last.

[14] See Affidavit of John P. Lube, AT&T Communications of the Southwest, Inc.'s Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish Interconnection Agreement with Southwestern Bell Telephone Company, Case Nos. TO-97-40, Too-97-67, ¶ 7 (filed December 19, 1996).

[15] *See* Comments of GTE and Its Affiliated Domestic Telephone Operations Companies, *Prescription Simplification,* FCC 93-452, at 14 (March 10, 1993).

*necessarily* a violation of TELRIC, *see Kansas/Oklahoma Order* ¶ 76, SWBT is careful to avoid any explanation of how it did, in fact, generate its Missouri proposals. *See* Smith Reply Aff. at ¶ 71 ("Mr. Baranowski *contends* that" SWBT used accounting lives). Upon further investigation, it now appears that that SWBT's proposals were based upon nothing more than "black box" subject matter "expert" opinions, (a handful of which were later arbitrarily adjusted by the Missouri PSC Staff based on "benchmarking" considerations). *See* Staff Report at 94-114; Lube Rebuttal Aff. at 18-20 (relevant pages attached). Accordingly, there is no basis for any finding that the SWBT proposals properly account for obsolescence – indeed, there is no basis even for a description of how SWBT's proposals were determined.

SWBT's general statements that UNE competition and technological innovation threaten to speed the rate of obsolescence of the modeled network are both wrong and irrelevant. Only facilities-based competition, not UNE-based competition, could increase the risk of obsolescence of SWBT's facilities; indeed, if anything UNE-based competition should serve to *decrease* such risk by ensuring that SWBT's network is used (and by reducing incentives for SWBT to replace or update old or outdated plant in order to attract new customers) even in the face of competition.[16] And, as SWBT has itself recognized, recent technological advances have tended to increase, not decrease the useful lives of existing plant. *See, e.g.*, Mark Emery & Beth Gage, *The Evolution of xDSL-Based Services*, Technological Paper for AG Communications Systems (2001) ("adjunct or integrated DLC support for xDSL and better loop qualification procedures will extend the life of the copper plant almost indefinitely").[17] In any event, as the Commission has recognized, its prescribed depreciation lives already account for obsolescence. *See Depreciation Order* ¶ 61, n.167 ("Commission-authorized depreciation lives are not only estimates of the physical lives of assets, but also reflect the impact of technological obsolescence and forecasts of equipment replacement"); *see also See* Third Report and Order, *FCC Simplification of the Depreciation Prescription Process*, CC Docket No. 92-296 FCC 95-181, ¶ 11 (released May 4, 1995) (Commission's lives are based upon "statistical studies [that] required detailed analyses of each carrier's plant retirement pattern, the carriers' plans, and the current technological developments and trends").[18]

---

[16] The relevant risk for computing an incumbent LEC's depreciation rates is the risk incurred in the *wholesale* business of supplying UNEs, not the retail business of providing local services to end users. *See Local Competition Order* ¶ 702.

[17] Available at http://www.agcs.com/supportv2/techpapers/xdslev.htm.

[18] SWBT's claim that AT&T made "an egregious misrepresentation," Smith Decl. ¶ 70, in failing to rely on the AT&T depreciation lives cited by the Missouri PSC staff is particularly disingenuous. As SWBT is aware, the AT&T lives cited by staff were prescribed by the FCC for AT&T's long distance plant in 1995 (FCC 95-32, released January 31, 1995). Since AT&T had no local loops or local switches at that time, these lives were properly excluded by Mr. Baranowski. As the Commission explicitly recognized, "the underlying considerations that go into estimating the basic factors are sufficiently different for [LECs and IXCs] that they should be considered separately." Depreciation Simplification Order, *Notice of Proposed Rulemaking*, 8 FCC Rcd. 146, 148 (1992); *see also Depreciation Order* ¶ 18, n.2. The average projection life prescribed for the thirteen LECs in the January 1995 Order were as follows: ESS Digital, 17.0; Circuit Digital 12.0; Underground Metallic Cable 25.3; Buried Metallic

*Common Cost and Maintenance Factors.* SWBT concedes that the extraordinarily high common cost ratio used to estimate its UNE rates was based solely on SWBT's own historical common cost experience without regard to whether an efficient cost-minimizing competitor would maintain a lower common cost ratio. *See* Smith Reply Aff. ¶ 73. SWBT likewise concedes that its application of its ratio calculated from a historical expense base that did not include return on capital to a total UNE cost figure that *did* include return on capital resulted in a "mismatch" that overstates costs.[19] *See id.* ¶¶ 73-74; SWBT Reply at 10. *See also* AT&T Comments at 18, AT&T Reply Comments at 15-17. SWBT's response is to claim that "Missouri's common cost factor of 16.47 percent is on the low end of states within SBC's region." SWBT Reply at 11. That is absurd. As AT&T demonstrated, the Missouri common cost factor is much *higher* than the common cost factors used to set rates in the other states in which SBC has sought and obtained section 271 approval. *See* Baranowski Decl. ¶ 25. If SWBT is correct that the Ameritech, SNET and Pacific Bell states in which it has not even sought section 271 approval of its rates reflect still higher common cost ratios, that is a reason to question whether rates in those states are cost-based, not a reason to assume that SWBT's Missouri rates are cost-based.[20]

SWBT's Common Cost Factor is, by any possible measure far too high. As AT&T demonstrated, using 1998 ARMIS data (rather than the 1995 data used by SWBT), and correcting for SWBT's conceded mismatch, results in a common cost factor of about 8% – less than half the figure used to set SWBT's Missouri rates. And the recently released 2000 ARMIS

---

Cable, 25.1. All of these lives are longer than those used to develop SWBT's Missouri UNE rates. *See* Smith Decl. ¶ 70 (column in Table entitled "UNE Missouri").

[19] Although it proposes no alternative fix for its conceded common cost mismatch, SWBT takes issue with AT&T's observation that using revenues (which include return on capital) as the base for calculating the ratio would have avoided the mismatch. *See* Smith Reply Decl. ¶¶ 80-81. According to SWBT, "using total revenues as the denominator would severely understate the common cost factor" because "the total revenues also recover the cost of money and income tax requirements associated with assets attributable to marketing and services, common operations, and network operations general supervision." Smith Reply Decl. ¶ 85. This argument is a red herring. With revenues as the *starting point* instead of expenses, the common cost related items identified by SWBT – which were deducted from total expenses in SWBT's own common cost study – would also be properly deducted from total revenues before computing the ratio.

[20] SWBT also asserts that its efficiency gains from its recent mergers will not affect its common cost factor because those "[m]erger savings would not only affect the numerator, but also the denominator in [the common cost factor]." Smith Decl. ¶¶ 75-76. This reflects bad math. SWBT has explained that its recent mergers will reduce its common costs, not other costs. *See e.g.*, SBC 2000 Annual Report at 27 (stating that recent mergers will allow SWBT to "consolidate a number of corporate activities"). However, SWBT's common cost factor does not include common costs in the denominator; common costs are only reflected in the numerator. *See* Baranowski Decl. ¶ 24. Therefore, SWBT's efficiency gains will work to lower the numerator while leaving the denominator unchanged, resulting in a lower common cost factor. But even if SWBT's efficiency gains somehow reduce the numerator and denominator by the same absolute amount, SWBT's common cost factor would still decline precipitously because the relative change in the numerator (which includes *only* common costs) would be much larger than the relative change in the denominator, thereby decreasing the common cost factor (for instance reducing the numerator and the denominator of the fraction ¾ equally by the number one produces (3-1)/(4-1) or 2/3, a lower number).

data shows that even that figure is too high to satisfy forward-looking TELRIC standards – notwithstanding its continuing local dominance, SWBT's common cost factor using this 2000 data is only 6.8% (chart attached).[21]

*ACES Model.* AT&T demonstrated that SWBT's "ACES Model" violates TELRIC principles by incorporating embedded cost factors. *See* Baranowski Decl. ¶¶ 26-28. SWBT concedes that its ACES Model includes factors that are based on "historical information" but claims to have made adjustments to those factors to make them forward-looking." Smith Decl. ¶ 82. But the adjustments described by SWBT are entirely unresponsive to TELRIC issues raised by AT&T and DOJ.

In particular, AT&T has explained that SWBT's ACES Model relies on power and telecommunications engineering factors that are based on SWBT's embedded costs. In reply, SWBT claims to have addressed that problem by transforming those embedded cost factors into forward-looking costs by multiplying those factors by a ratio of current costs to booked costs. *See* Smith Decl. ¶ 82. But this process does not account for the fact that SWBT's power and telecommunications engineering factors account for tasks that should not have been included its power and telecommunications engineering factors in the first place. For instance, SWBT's power and engineering factors include tasks such as retrofitting and modifying SWBT's embedded plant to accommodate new equipment, as well as the removal of obsolete equipment – tasks that are not required in a forward-looking network. See Baranowski Decl. ¶ 27. Merely reducing these values with a forward-looking ratio cannot correct this error – in a truly forward-looking study there would be *no* such costs.

**B. Loop-Specific TELRIC Violations.**

*Fill Factors.* SWBT concedes that its rates reflect "*actual* fill factors for distribution cable based on *current levels of total capacity*," Smith Reply Decl. ¶ 44 (emphasis added), rather than a forward-looking estimate of efficient levels of spare capacity as required by TELRIC. SWBT recognizes that the resulting distribution fill factor of 40 percent "seems low" but speculates that "some areas may experience unexpectedly large demand increases." Smith Reply Decl. ¶ 51. But, as the Commission has recognized, leaving nearly two-thirds of distribution plant idle is neither efficient nor forward-looking; rather, an efficient provider would design its distribution network to be filled at 50-75 percent of capacity. *See Inputs Order* ¶ 188 n.392. *See also Kansas/Oklahoma 271 Order* ¶ 80 (pointing out that "the Kansas Commission adopted a 53 percent fill factor for distribution cable, and the New York Public Service Commission adopted a 50 percent fill factor); Baranowski Decl. ¶ 32 (noting that the "mid-point of the distribution fill factors adopted in Massachusetts is 52.5%"); *Inputs Order* ¶ 195 ("The

[21] SWBT's maintenance factors are also inflated by its use of embedded costs. SWBT's factor development process results in the inclusion of the costs of SWBT's own customer non-recurring activities (*e.g.*, new installations) being improperly included in the TELRIC recurring rates. For this reason, the Texas commission and the advisory consultant in the Oklahoma proceeding required reductions in SWBT's maintenance factors. And the Kansas Commission eliminated approximately 38% of SWBT's "M-coded" maintenance costs (excluding switch RTU fees). No adjustment was made to the Missouri cost studies to address SWBT's inflated maintenance factors.

administrative fill factors are determined per engineering standards and density zone conditions. These factors are independent of an individual company's experience and measured effective fill factors. The administrative fill factors would be the same for every efficient competitive firm").

SWBT complains that the Commission should not rely on its Synthesis Model fill factor findings because the Commission ruled in the *Kansas/Oklahoma 271 Order* that the Synthesis Model should not be used to estimate UNE rates. *See* Smith Decl. ¶ 6. But in that very same order the Commission recognized that the appropriateness of measuring UNE fill factors against its Synthesis Model findings. *See Kansas/Oklahoma 271 Order* ¶ 80. That is because, regardless of any other incongruities between the Synthesis Model and the Commission's TELRIC rules, the Commission employed the same forward-looking approach to estimating fill factors in its universal service proceedings that it has required in the UNE context. SWBT nonetheless urges the Commission to disregard its Synthesis Model fill findings – the product of nearly two years of intensive workshops and litigated proceedings to which SWBT was a party – because the Commission "effectively approved" a 40 percent fill factor "in granting Southwestern Bell's section 271 application in Texas. SWBT Reply at 13. The Commission did no such thing. SWBT's Texas distribution fill factors were not even litigated in the section 271 proceeding and thus the Commission had no occasion to approve them, implicitly or otherwise.[22]

*Conduit Sharing.* SWBT provides no justification for its extremely low conduit sharing assumption of 0.09 percent. A proper forward-looking approach would, at a minimum, account for the fact that new local telephone entrants in Missouri would seek out opportunities to share both existing and planned underground structure (most of which is conduit in Missouri) as a means of controlling costs. *See* Baranowski Reply Decl. ¶ 11. The Commission's Synthesis Model, for instance, assumes an average 40 percent sharing rate for underground structure investment in Missouri. *See id.* SWBT's near-zero sharing assumption cannot be considered to be anywhere near the "range of reasonableness."

*Digital Loop Carrier ("DLC").* As SWBT has explained, "one of the key factors underlying DLC costs is whether the system is integrated with the serving end office." Smith Decl. at A-18. An integrated DLC ("IDLC") is more efficient and less costly because it is connected directly to the switching system so that digital signals from customers do not have to be converted back to analog signals. *See, e.g.*, Smith Decl. at A-18 (using integrated DLCs "saves from having to have central office terminating equipment for the DLC system"). Yet SWBT's rates reflect an assumed network with IDLC employed a mere 25 percent of the time.

---

[22] The Commission has repeatedly stated that it generally will consider those issues raised by the parties to a Section 271 proceeding. *See, e.g. Mass. 271 Order* ¶ 15 (the Commission will "focus attention on the section 271 requirements commenting parties address most extensively, while streamlining the discussion of the other less controversial requirements"). Any suggestion that the Commission has "approved" every input to every cost study used to determine every rate in a state in which the BOC receives 271 authority would essentially require parties to a section 271 proceeding to litigate every input for every element.

Incredibly, SWBT claims on reply that the DLC ratio should have been set at *zero* because "[u]nbundled loops cannot be extracted or 'groomed' from an IDLC system without significant additional expense." Smith Decl. ¶ 61. SWBT provides no cost study support for any such assumption, much less the data and electronic cost studies that would be necessary to test the assertion that these unidentified unbundling costs would exceed the enormous central office savings associated with IDLC. Moreover, SWBT is simply wrong in asserting that unbundled loops cannot be extracted from efficient IDLC systems. Most fundamentally, no such "extraction" is even necessary in the UNE-P scenario through which almost all UNE-based customers are served. But it is by now well established that loops can, in any event, quite easily be extracted from modern IDLC systems at little or no additional cost.[23]

*Dark Fiber.* SWBT does not dispute that its loop rates are inflated with dark fiber costs. SWBT justifies this mismatch on the grounds that it failed to include those costs in its dark fiber rates. *See* SWBT Reply at 15. That might provide SWBT a justification for seeking to increase its dark fiber rates, but it certainly cannot justify misallocating dark fiber costs to loop rates. In the alternative, SWBT argues that the dark fiber costs belong in loop rates because CLECs might not purchase its dark fiber separately. *See* Smith Reply Aff. ¶ 65. On that "logic," if CLECs are only buying loops, then switching and transport costs ought to go into loop rates as well. Fortunately, that approach is expressly forbidden by the Commission's TELRIC rules. 47 C.F.R. 51.505(d)(4) (expressly disallowing recovery of costs to "subsidize . . . services . . . other than the element for which a rate is being established"); *see also Local Competition Order* ¶¶ 682 (allowing incumbent LECs to "recover the forward-looking costs directly attributable to the specified element. . . . Directly attributable forward-looking costs include the incremental cost of facilities and operations that are *dedicated to that element*") (emphasis added).

*Cable Tapering.* SWBT concedes that its cost studies make no express provision for the loop tapering that any efficient provider would employ. *See* SWBT Reply at 14; MPSC Staff Report at 18 ("a feeder segment may originate as a very large cable and taper as the cable terminates to multiple [feeder distribution interfaces]"). Failure to include tapering feeder plant in a cost study "increase[s] the cost of the feeder segment because it precludes the use of large size cable at the beginning of the feeder segment and fails to recognize the tapering of the feeder cable." *Id.*

SWBT claims that by basing cable costs on its existing cable inventory, rather than on efficiently designed forward-looking cable placement, it has compensated for this error by understating distribution cable costs while overstating feeder cable costs. *See* Smith Reply Decl. ¶ 43. As noted above, that explanation merely confirms that SWBT violated TELRIC by employing unlawful reproduction cost assumptions. In any event, SWBT has provided no

---

[23] *See, e.g., New York Re-Examination Decision at* 92 ("CLECs argue credibly that [integrated DLC] technology should be able to obviate UDLC [*i.e.*, non-integrated DLC] in the near future if it cannot already do so, and that a properly forward-looking TELRIC analysis should take into account those developments"). Some IDLC systems may accomplish loop extraction at the DS1 level, but no CLEC would incur the expense of collocation at an ILEC central office it if did not expect to serve at least 24 customers from major DLC systems.

evidence that the two claimed errors exactly cancel each other out or, indeed, that its cable cost assumptions caused any understatement at all. Again, SWBT's burden is to *prove* that its rates are TELRIC-compliant not merely to declare that is so. If SWBT wanted the Commission to rely upon the intricacies of its cost models, it should have provided the Commission and commenting parties with full electronic access to those models. It chose not to do so, and its unsupported allegations about the rate impacts of particular assumptions in those cost studies must therefore be disregarded.[24]

### C. Switch-Specific TELRIC Violations.

*Switch Discounts.* SWBT's switch usage rates in Missouri are among the highest in its five state region even though Missouri costs are among the lowest. *See* Baranowski Decl., Table 2. These switch usage rate/cost disparities reflect SWBT's use of switch discounts that are based upon "attributable growth" – *i.e.*, the volume and type of switches needed to expand SWBT's *existing* network – rather than the switch discounts that an efficient new provider would obtain to build out an efficiently sized network. *See* Staff Report at 32; *Local Competition Order* ¶ 684.

SWBT argues that basing switching costs on the costs of purchasing new switches at the best available discount would result in a "flash-cut" of switch investment "at a single point in time" and is therefore not an appropriate measure of switch discounts. Smith Reply Decl. ¶ 24. To the contrary, such a "flash cut" of switch investment is precisely what the Commission's TELRIC methodology contemplates. As the Commission has stated, the rates for network elements should be "based on costs that assume that wire centers will be in place at the incumbent LEC's current wire center locations, but . . . the *reconstructed* local network will employ the most efficient technology for reasonably foreseeable capacity requirements." *Local Competition Order* ¶ 685.[25] And it is for precisely these reasons that the Commission specifically rejected incumbent LEC arguments that "costs associated with upgrading switches" should be included in its Synthesis Model and instead held that forward-looking switching costs

---

[24] Moreover, what is available in the record strongly suggests that SWBT's newly minted claim is baseless. As an initial matter, when asked by the Missouri Staff to quantify and address the cable tapering problem, SWBT feigned ignorance, claiming that it did not have any data related to the cable tapering and could not incorporate tapering into its loop cost study. *See* Staff Report at 18. The few cost study files that SWBT has recently provided belie any notion that the feeder/distribution allocation SWBT now claims solves the problem. Even the largest cable pair in SWBT's cable cost study documentation is much smaller than 4200 pairs. SWBT therefore cannot claim that its cost studies taper 4200 pair cable feeder down to 600 pair cable feeder at the FDI. *See* Smith Decl. ¶ 43. Moreover, SWBT's cost study documentation shows that a single sized cable is assigned to each FDI, further refuting SWBT's claims that its cost studies account for tapering of different sized cable pairs at the FDI.

[25] *See also Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp. at 238 (agreeing that the "long-run" requirement of the TELRIC standard "says rip every switch out. All of them. . . . Every switch in the network, rip them out. Leave . . . wire center locations where they are. And build the network that you would build today to serve demand").

should be determined using newly purchased switches efficiently sized to meet existing demand. *Inputs Order* ¶ 315.[26]

SWBT's explanation for its failure to apply switch discounts to engineering and installation – that the particular SWBT contracts that it elected to provide to the Missouri PSC do not provide discounts for engineering and installation – is equally inconsistent with the TELRIC rules. The question is not whether those particular SWBT contracts include such discounts but whether an efficient provider reconstructing a network today could and would demand them. The Texas switch usage cost studies recently produced by SWBT show that the Texas Staff ordered the switch discounts to be applied to materials, installation and engineering.[27] *See also* Arbitration Award, Public Utilities Commission of Texas, Docket Nos. 16189, 16196, 16226, 16285, 16290, 16455, 17065, 17579, 17587, 17781, at Appendix A, page 1, Issues 2-7 (December 17, 1997).

*Hardware factor.* SWBT's response to the Missouri PSC's concern that SWBT may have double-counted port costs through its hardware factor is again simply to declare, without the slightest explanation or support, that its cost studies handled the matter correctly. *See* Smith Decl. ¶¶ 30-34. If the explanation was as straightforward as SWBT now makes it out to be, SWBT presumably would have explained the matter to the MPSC Staff's satisfaction. It did not do so, and its unsupported assertion on reply cannot be credited, particularly in light of SWBT's admission in the Kansas rate proceedings that it *did* double recover such costs. *See* Order Setting Inputs for Cost Studies, *Joint Application of Sprint et al. to Open a Generic Proceeding on SWBT's Rates for Interconnection, Unbundled Elements, Transport, and Termination, and Resale,* Docket No. 97-SCCC-149-GIT, at A-71 (pointing out that SWBT concedes that it double recovers for universal tone receivers, once through the hardware factor and once through the SCIS model).

**D. Non-Recurring Charges.**

SWBT does not deny that its Missouri NRCs greatly exceed its NRCs in other states, including even Kansas and Oklahoma, where SWBT's NRCs are far too high and are the subject of a pending appeal. As the Kansas Corporation Commission has recognized, non-recurring charges "should not be expected to vary significantly across SWBT's jurisdictions because the activities associated with the NRCs are expected to be very similar across these

---

[26] In particular, the Commission has found that "[s]witches, augmented by upgrades, may provide carriers the ability to provide supported services, but do so at greater costs. Therefore, such augmented switches *do not constitute cost-effective forward-looking technology.*" *Inputs Order* ¶ 317 (emphasis added).

[27] Further, SWBT's attempt to justify its Missouri switching rates by comparing them to those proposed by AT&T in Texas confirms that SWBT's Missouri UNE switch rates are excessive. *See* Smith Decl. ¶ 23. The UNE switch rates relied on by SWBT in this proceeding are about 50 percent higher than those proposed by AT&T in Texas. *See id.*

jurisdictions."[28] SWBT notes that state commissions have required it to make state-specific adjustments to its non-recurring rates so that one should expect there to be *some* difference in non-recurring rates between states. *See* Smith Reply Decl. ¶¶ 101-102. But that can hardly explain differences of as much as several hundred percent. *See, e.g.,* AT&T Reply Comments at 13. Further, the "state-specific" adjustments to which SWBT refers did not reflect any cost differences but merely varying state responses to SWBT's uniformly bloated NRC proposals based on unlawful manual processing.

**E. Interim Rates.**

Fully *half* of SWBT's Missouri UNE rates are interim rates. *See, e.g.,* AT&T Reply Comments at 25. That is far more than in any other state that has obtained section 271 approval. Further, many of these interim rates were those proposed by SWBT for the first time in its state section 271 application and were simply rubber-stamped by the Missouri PSC with no review to determine whether they were even close to TELRIC-based rates. *See id.* SWBT's only response is to point out that many of the interim rates have been set at zero. But that is entirely beside the point – even if *all* of the interim rates were set at zero, the reality is that the Missouri PSC could establish competition-foreclosing permanent rates that bear no relation to costs.[29] It is simply impossible for competitive LECs to develop and implement market entry plans with such uncertainty as to what rates will ultimately prevail for so many critical network elements, and, contrary to SWBT's claim no Commission precedent does – or could – justify granting a section 271 application in these extraordinary circumstances.

For the reasons stated above, and in AT&T's prior comments in this proceedings, SWBT's Missouri Application should be denied.

Sincerely,

David L. Lawson

cc: D. Atwood
G. Reynolds
J. Jackson
R. Lerner
T. Navin
G. Remondino

[28] *See* Order on Reconsideration, *Joint Application of Sprint et al. for the Commission to Open a Generic Proceeding on Southwestern Bell Telephone Company's Rates for Interconnection, Unbundled Elements, Transport and Termination and Resale*, Docket No. 97-SCCC-149-GIT, at 26 (September 1, 1999).

[29] In all events, none of the zero interim rates would affect SWBT's excessive UNE-Platform rates.

# Attachment 1

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

| | | |
|---|---|---|
| In the Matter of the Petition of AT&T Communications of the Southwest, Inc for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish Interconnection Agreements with Southwestern Bell Telephone Company | ) | Case No TO-97-40 |
| Petition of MCI Telecommunications Corporation and its Affiliates, Including MCImetro Access Transmission Services, Inc for Arbitration and Mediation Under the Federal Telecommunications Act of 1996 of Unresolved Interconnection Issues With Southwestern Bell Telephone Company | ) | Case No TO-97-67 |

AFFIDAVIT OF JOHN P LUBE

STATE OF MISSOURI )
) SS
CITY OF ST LOUIS )

I, John P Lube, of lawful age, being duly sworn, depose and state

1 My name is John P LUBE I am presently Director - Capital Recovery for Southwestern Bell Telephone Company
2 Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3 I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief

John P. Lube
John P Lube

Subscribed and sworn to before this 25th day of September 1996

Notary Public

MARY ELLEN KALAPINSKI
NOTARY PUBLIC STATE OF MISSOURI
ST LOUIS CITY

A. The FCC, in its "depreciation simplification" docket, granted AT&T broad latitude in selecting its own depreciation lives, by allowing AT&T to use the Price Cap Carrier Option of its new simplification rules. FCC's Report and Order in CC Docket No. 92-296 (FCC 93-452), released October 20, 1993. As explained in this FCC Order (at par 92), AT&T was allowed this latitude because, at that time, it operated in "a more competitive environment than the [local exchange carriers]" (i.e., in the interexchange market). However, because AT&T and SWBT will now compete with each other in the local exchange market, it is both logical and reasonable that SWBT's economic lives will be more nearly the same as those already allowed for AT&T by the FCC, rather than the longer lives currently prescribed for SWBT by the FCC in its Order FCC 96-22 (and proposed for SWBT by AT&T and MCI in this proceeding).

Q WHAT ECONOMIC LIVES DOES SWBT BELIEVE TO BE APPROPRIATE?

A The proper, forward-looking economic lives which should be used in SWBT's TELRIC studies are shown for the most significant asset types in the following table. The proposals made by AT&T and MCI for the corresponding types of assets are also shown for comparison.

Table 3

| Plant Type | SWBT's Proposed Economic Life | AT&T's & MCI's Proposed Economic Life |
|---|---|---|
| Digital Switching | 9.4 | 12.7 |
| Digital Circuit | 5.8 | 10.3 |
| Copper Cable | 8.3 - 16.3 | 19.0 - 20.9 * |
| Fiber Cable | 20.4 - 25.7 | 19.0 - 20.9 * |

* The range of lives proposed by AT&T and MCI for the Loop Distribution, Loop Feeder, Transport Facilities, and Signaling Links network elements is used as a surrogate to represent their proposals for Copper Cable and Fiber Cable.

Q HOW DID SWBT DETERMINE ITS PROPOSED ECONOMIC LIVES FOR THESE SIGNIFICANT ASSET TYPES?

A The primary inputs into the determination of SWBT's economic lives are its experience with these technologies, industry studies of technology substitution, and the expert opinion of Mr. Deere's network organization.

Q. OF WHAT VALUE ARE THESE INPUTS INTO SWBT'S FORWARD-LOOKING ECONOMIC LIVES?

A. A combination of these inputs is applicable to each of these asset categories. For example, SWBT has had considerable experience in the actual economic lives exhibited by the various components of digital switches. Industry forecasts and analyses of future changes to the network also support the economic lives indicated by the past turn-over rates for

these various components. Furthermore, SWBT's network experts provide insight into future changes in this technology and its applications within the network.

Q. WHY WOULD THIS PAST EXPERIENCE AND THE INDUSTRY STUDIES BE RELEVANT TO THE FORWARD-LOOKING LIFE OF THE CURRENT DIGITAL SWITCH TECHNOLOGY THAT WOULD BE DEPLOYED BY AN EFFICIENT COMPETITOR?

A. These are relevant simply because the lives of the components of current digital switch technology, deployed in the future, will be subject to the very same drivers of obsolescence that have already been observed for SWBT's existing digital switch investment. These drivers consist of (a) technology advances in areas such as computer chip density, processor speeds, power consumption, and storage media; (b) customers needs for more advanced, sophisticated services, and (c) the effects of competition on switch capabilities and features, spurred on by the availability of new technology and customer demand. In other words, these drivers have already triggered, and will continue to trigger in the future, the replacement of these various components, such as switch processors, memory, and line interface equipment.

Q. HOW ARE THESE INPUTS RELEVANT FOR THE DIGITAL CIRCUIT EQUIPMENT AND CABLE PLANT USED FOR BOTH THE LOOP AND TRANSPORT?

A. First, even though the latest-available technology for this portion of the network is fiber-based SONET (which certainly allows an efficient design for higher-bandwidth and/or

survivable services), it is not the most efficient technology for serving all customers. For example, a competitor's efficient network for narrowband services will certainly include considerable amounts of other currently-available technologies such as copper cable, or fiber-fed and copper-fed non-SONET digital loop carrier.

Second, because of the likely use of all of these technologies (i.e., copper and fiber, non-SONET and SONET) in a forward-looking network build-out, SWBT's experience with all of these technologies provides a valuable basis for determining the economic lives for this plant. In addition, the industry studies for the technology substitution of fiber for copper, SONET for non-SONET, and faster SONET for slower SONET provide further, relevant input for determining these economic lives

## II Net Salvage for TELRIC Investment

Q. **PLEASE EXPLAIN MR. FLAPPAN'S AND MR. JERNIGAN'S OMISSION RELATED TO NET SALVAGE.**

A. **Mr. Flappan, Mr. Jernigan, and the Hatfield model they use fail to acknowledge the depreciation costs associated with the net salvage for the network investments identified by the Hatfield model.**

Q WHAT IS NET SALVAGE?

# Attachment 2

# Common Cost Factor * - ARMIS 43-03 Total Regulated

| Company | State | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bell South | | 8.9% | 9.6% | 9.4% | 12.0% | 11.7% | 9.9% | 7.0% | 6.3% | 6.0% |
| Qwest | | 14.5% | 14.8% | 14.4% | 13.2% | 13.3% | 14.2% | 14.8% | 12.3% | 15.1% |
| SWBT | | 13.3% | 13.0% | 13.3% | 12.5% | 10.9% | 12.1% | 9.5% | 8.2% | 6.8% |
| Verizon | | 11.1% | 12.1% | 15.7% | 14.6% | 13.1% | 12.5% | 12.4% | 10.1% | 9.1% |
| Total RBOC | | 11.9% | 12.3% | 13.4% | 13.1% | 12.0% | 12.1% | 10.5% | 8.9% | 8.3% |

*** Common Costs / (Total Revenue - Common Costs)**